85-421
No.

Supreme Court, U.S.
FILED
SEP 10 1985
JOSEPH F. SPANIOL, JR.

In The

Supreme Court of the United States

October Term, 1985

PRUDENTIAL-BACHE SECURITIES INC.,

Petitioner,

vs.

LAURA ANGELASTRO,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

LEONARD BARRACK
DANIEL E. BACINE
SAMUEL R. SIMON
Attorneys for Petitioner
Suite 2100
1845 Walnut Street
Philadelphia, Pennsylvania 19103
(215) 963-0600

2747
Lutz Appellate Printers, inc.
•NJ (201) 257-6850•NY (212) 840-9494•PA (215) 563-5587
MA (617) 542-1114•DC (202) 783-7288•USA (800) 5 APPEAL

QUESTION PRESENTED

Whether a private right of action may be implied under Rule 10b-16 of the Securities and Exchange Commission.

STATEMENT PURSUANT TO RULE 28.1

Petitioner Prudential-Bache Securities Inc. is wholly owned by The Bache Group Inc., which is wholly owned by Prudential Insurance Co.

TABLE OF CONTENTS

	Page
Question Presented	i
Statement Pursuant to Rule 28.1	ii
Table of Contents	iii
Table of Citations	iii
Opinions Below	1
Jurisdiction	2
Statutes and Rules Involved	2
Statement of the Case	3
A. Background	3
B. Proceedings Below	5
1. The Decision of the District Court	5
2. The Decision of the Court of Appeals	5
Reasons for Granting the Writ	6
Conclusion	15

Contents

Page

TABLE OF CITATIONS

Cases Cited:

Angelastro v. Prudential-Bache Securities Inc., 575 F. Supp. 270 ..... 5, 12

Angelastro v. Prudential-Bache Securities Inc., 764 F. 2d 939 ..... 5, 7, 8, 9, 12

Cannon v. University of Chicago, 441 U.S. 677 (1979) ... 7

Chemical Bank v. Arthur Anderson & Co., 726 F. 2d 930 (2d Cir. 1984) 9, 10

Clausen v. Beneficial Financial Co. of Berkeley, 423 F. Supp. 985 (N.D. Cal. 1976) 13

Cort v. Ash, 422 U.S. 66 (1975) 11

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 9

Haas v. Wiebold Stores, Inc., 725 F. 2d 71 (7th Cir. 1984) 12

Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) 8, 9

McCoy v. Salem Mortgage Co., 74 F.R.D. 8 (E.D. Mich. 1976) 13

Robertson v. Dean Witter Reynolds, Inc., 749 F. 2d 530 (9th Cir. 1984) 8, 12

Contents

Page

Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) 9

Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) 7, 8, 15

Watkins v. Simmons and Clark, Inc., 618 F. 2d 398 (6th Cir. 1980) 12, 13

Statutes Cited:

Section 10(b) of the Securities and Exchange Act...7, 8, 9, 10

15 U.S.C. § 78j(b) 2

15 U.S.C. § 78aa 4

15 U.S.C. § 78bb(a) 11, 14

15 U.S.C. § 1601 et seq. 7, 10

15 U.S.C. § 1640(a)(2)(A)(i)..... 13

15 U.S.C. § 1640(a)(2)(A)(ii) 13

28 U.S.C. § 1254(1)..... 2

28 U.S.C. § 1292(b)..... 5

Rules Cited:

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 .....3, 4, 5, 10

Contents

Page

Rule 10b-16 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-16 . . . i, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 13, 14, 15

SEC Rule 14a-7 12

SEC Rule 14a-9 12

Other Authorities Cited:

SEC Release No. 8733, 34 Fed.Reg. 19717 10

S. Rep. No. 392, 90th Cong., 1st Sess. 9 . . . . . 7, 11, 13

APPENDIX

Opinion of Court of Appeals 1a

District Court Opinion and Order 23a

Judgment of the United States Court of Appeals for the Third Circuit 35a

Complaint Filed in District Court 37a

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 . . . . . 45a

Rule 10b-16 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-16 . . . . . 46a

15 U.S.C. § 1640(a) 49a

No.

In The

Supreme Court of the United States

October Term, 1985

PRUDENTIAL-BACHE SECURITIES INC.,

Petitioner,

vs.

LAURA ANGELASTRO,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

OPINIONS BELOW

The opinion of the court of appeals is reported at 764 F.2d 939, and is set out in the Appendix hereto at 1a-22a.

The opinion of the district court is reported at 575 F.Supp. 270, and is set out in the Appendix hereto at 23a-32a.

JURISDICTION

The judgment of the court of appeals was entered on June 12, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-16 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-16, provides in pertinent part:

> "It shall be unlawful for any broker or dealer to extend credit, directly or indirectly, to any customer in connection with any securities transaction unless such broker or dealer has established procedures

> to assure that each customer (1) is given or sent at the time of opening the account, a written statement or statements disclosing (i) the conditions under which an interest charge will be imposed; (ii) the annual rate or rates of interest that can be imposed; (iii) the method of computing interest; (iv) if rates of interest are subject to change without prior notice, the specific conditions under which they can be changed; (v) the method of determining the debit balance or balances of which interest is to be charged and whether credit is to be given for credit balances in cash accounts; (vi) what other charges resulting from the extension of credit, if any, will he made and under what conditions,; and (vii) the nature of any interest or lien retained by the broker or dealer in the security or other property held as collateral and the conditions under which additional collateral can be required."

Rule 10b-16 is set out in its entirety in the Appendix hereto at 46a-48a.

STATEMENT OF THE CASE

A. Background

Respondent Laura Angelastro filed this action as a purported class action in the District Court for the District of New Jersey on April 4, 1983, claiming that petitioner Prudential-Bache Securities Inc., a national securities brokerage firm, and Bache Halsey Stuart Shields Inc., its corporate predecessor in interest, violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5 and 10b-16 promulgated thereunder by tne Securities and Exchange Commission. Federal jurisdiction was conferred on the district court by virtue of 15

U.S.C. § 78aa. Respondent sought to represent a class of "all persons who purchased securities through margin accounts maintained by either defendant" during the six-year time period 1977-1982 (Complaint ¶8, 39a). The gravamen of the complaint is respondent's claim that petitioner misrepresented the interest charges applicable to its margin account customers, and that these misrepresentations violate Section 10(b) of the Exchange Act and SEC Rules 10b-5 and 10b-16 (Complaint ¶16, 41a-42a).[1]

---

1. Paragraph 16 of the Complaint (41a-42a) contains five basic allegations of misrepresentation or failure to disclose, set out in ¶¶16(a) through 16(e) as follows:

¶16(a): (a) the "specific interest rate" applicable to each securities purchase transaction in a margin account;

(b) the interest rate "indicator" and the "spread" between this indicator and the interest rate;

(c) the relationship between the interest rate and the "broker's call rate."

¶16(b): The formula pursuant to which interest rates were assessed.

¶16(c): The availability of a method by which plaintiff could avoid certain interest charges and petitioner could pay certain interest.

¶16(d): The fact that an increase in the market value of securities purchases on margin does not affect the computation of interest charges applicable to a margin account.

¶16(e): The availability of other interest rates.

Paragraph 16(f) of the complaint repeats the general allegation that petitioner misrepresented its credit terms applicable to margin accounts.

B. Proceedings Below

1. The Decision of the District Court

Petitioner moved before the district court to dismiss the complaint on the ground that it did not state a claim upon which relief could be granted. By Opinion published at 575 F.Supp. 270 (23a-32a), the district court held that the activities alleged in the complaint were not undertaken "in connection with the purchase or sale of any security" within the meaning of Rule 10b-5. It therefore granted petitioner's motion to dismiss respondent's Rule 10b-5 claim. 575 F.Supp. at 272-274 (25a-29a). The district court held, however, that a private right of action may be implied under Rule 10b-16, and that the complaint adequately stated a claim under that rule. It therefore denied petitioner's motion to dismiss the Rule 10b-16 claim. 575 F.Supp. at 274 (30a-31a).

2. The Decision of the Court of Appeals

Upon application by both parties, the district court certified its rulings on both Rule 10b-5 and Rule 10b-16 for interlocutory appeal pursuant to 28 U.S.C. § 1292(b), and the Court of Appeals for the Third Circuit granted both petitions.

A panel of the court of appeals reversed in part and affirmed in part the orders of the district court on June 12, 1985. *Angelastro v. Prudential-Bache Securities Inc.*, 764 F.2d 939 (1a-22a). Disagreeing with the district court, the court of appeals held that the misrepresentations regarding respondent's margin account set forth in paragraph 16 of the complaint (41a-42a) "may be 'in connection with' the purchase or sale of a security" within the meaning of Rule 10b-5, 764 F.2d at 941 (13a), and therefore reversed the district court on the Rule 10b-5 issue. 764 F.2d at 942-946 (4a-14a). In agreement with the district court, the court of appeals held that a private right of action may be implied under

Rule 10b-16, and therefore affirmed the district court on the Rule 10b-16 issue. 764 F.2d 946-950 (14a-21a).

REASONS FOR GRANTING THE WRIT

Rule 10b-16 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-16 (46a-48a), prohibits a broker from extending credit to a customer unless he has "established procedures to assure that [the] customer . . . at the time of opening the account" (46a), is furnished a written statement disclosing, *inter alia*,

> (i) the conditions under which an interest charge will be imposed;
>
> (ii) the annual rate or rates of interest that can be imposed;
>
> (iii) the method of computing interest;
>
> (iv) if rates of interest are subject to change without prior notice, the specific conditions under which they can be changed;
>
> (v) the method of determining the debit balance or balances on which interest is to be charged and whether credit is to be given for credit balances in cash accounts;
>
> (vi) what other charges resulting from the extension of credit, if any, will be made and under what conditions; and
>
> (vii) the nature of any interest or lien retained by the broker or dealer in the security or other

property held as collateral and the conditions under which additional collateral can be required.

The Commission adopted Rule 10b-16 in response to Congress' instructions to require substantially similar disclosure of credit costs by broker-dealers as it contemporaneously required in non-securities credit transactions in the Truth in Lending Act, 15 U.S.C. §§ 1601 *et seq.* See S. Rep. No. 392, 90th Cong., 1st Sess. 9.

This Court has held that "under certain limited circumstances" a private right of action may be implied in a statute or rule that does not expressly provide one. *Cannon v. University of Chicago,* 441 U.S. 677, 717 (1979). Where, as here, the rule in question "by its terms grants no private rights," but merely prohibits specified conduct, the Court has held that the "central inquiry" is "whether Congress intended to create, either expressly or by implication, a private cause of action." *Touche Ross & Co. v. Redington,* 442 U.S. 560, 575-576 (1979).[2] The context in which the issue arose below was the implication of a private right of action from a rule of the Securities and Exchange Commission, rather than from a statute. The inquiry, however, is identical: the court must determine whether Congress intended to create a private right of action. *Touche Ross & Co. v. Redington,* 442 U.S. at 575.

The analysis of the court of appeals turned on the question "whether implying a private right of action will further the purpose of the enabling statute" — in this case Section 10(b) of the Securities Exchange Act. 764 F.2d at 947 (16a). This formulation

---

2. Where a statute or rule granted specified rights to an identifiable class of persons, but provided no means for their enforcement, this Court has implied a private right of action to provide a remedy for the violation of those rights. *Cannon v. University of Chicago,* 441 U.S. 677, 690 n.13 (1979). Here, by contrast, Rule 10b-16 by its terms grants no rights to anyone.

— which the court of appeals borrowed from *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 537 (9th Cir. 1984), which also implied a private right of action under Rule 10b-16 — led the court below into error. The implication of a private right of action under virtually any administrative rule would presumptively further the purpose of the statute under whose authority the rule was promulgated. Thus, an inquiry whether the right of action furthers the purpose of the statute must always be answered in the affirmative. Under the approach adopted by the court of appeals, every administrative rule that prohibits specified conduct can be transformed into a vehicle for extracting damages from the entity whose conduct the rule proscribes.

Under *Touche Ross & Co. v. Redington*, 442 U.S. at 575, the inquiry is not (as the court of appeals believed) whether a lawsuit "will further the purpose of the enabling statute" (764 F.2d at 947, 16a), but what Congress intended. The court of appeals reasoned that, since an implied private right of action exists under Section 10(b) (764 F.2d at 948, 17a-18a), and the Commission promulgated Rule 10b-16 under the authority bestowed upon it by Section 10(b), "granting private parties the ability to bring suit under the rule will further the substantive purposes of the enabling statute." 764 F.2d at 947 (17a).

The error of the court of appeals lay in its confusing the implied right of action recognized under Section 10(b) *in conjunction* with Rule 10b-5 with what it postulated to be the existence of an implied private right of action under Section 10(b) of the Securities Exchange Act. But there is not now, and has never been, an implied right of action *under Section 10(b) alone.* As this Court emphasized only two years ago, it is the existence of "a private right of action under Section 10(b) of the 1934 Act *and Rule 10b-5*" that is simply "beyond peradventure." *Herman*

& MacLean v. Huddleston, 459 U.S. 375, 380 (1983) (emphasis added).[3]

Once the court of appeals accepted the hypothesis that an implied right of action exists under Section 10(b) alone (764 F.2d at 948, 17a-18a), its holding that a private right of action should be implied under Rule 10b-16 was preordained. Under the court of appeals' logic, such a right *must be* implied under each and every rule promulgated by the Securities and Exchange Commission pursuant to Section 10(b). This is because Section 10(b) makes unlawful "any manipulative or deceptive device or contrivance *in contravention of such rules and regulations as the [Securities and Exchange Commission] may proscribe.*" Under the reasoning of the court of appeals, the Commission itself would be granted the power to create a private right of action for violation of *any* Commission regulation by simply numbering it as a Rule 10b regulation. Such a proposition is untenable. To create an implied private right of action is to create law, and as this Court has explained, "[t]he rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 213 (1976).

"The purpose of § 10(b) and Rule 10b-5 is to protect persons who are deceived in securities transactions." *Chemical Bank v. Arthur Andersen & Co.,* 726 F.2d 930, 943 (2d Cir. 1984)

---

3. The court of appeals found support for its statement that "courts have found an implied private right of action under Section 10(b) of the Exchange Act" (764 F.2d at 948, 17a) in this Court's decision in *Superintendent of Insurance v. Bankers Life & Casualty Co.,* 404 U.S. 6, 13 n.9 (1971). But, as the Court recently made clear in *Herman & MacLean v. Huddleston,* 459 U.S. 375, 380 n.10 (1983), the implied right of action whose existence was recognized in Superintendent of Insurance was one "brought under Section 10(b) *and Rule 10b-5.*"

(Friendly, J.).[4] The purpose of Rule 10b-16 is altogether different: it seeks merely to aid a borrowing investor's understanding of the terms and conditions of his loan. As the Securities and Exchange Commission itself explained, the purposes of Rule 10b-16 are as follows:

> "The initial disclosure is designed to insure that the investor, before his account is opened, understands the terms and conditions under which credit charges will be made. This will enable him to compare the various credit terms available to him and to understand the methods used in computing the actual credit charges." SEC Release No. 8733, 34 Fed.Reg. 19717.

These purposes are exactly those that Congress had in mind when it enacted, not the federal securities laws, but the Truth in Lending Act, 15 U.S.C. § 1601 *et seq*. As Congress stated therein:

> "It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices." 15 U.S.C. § 1601(a).

---

4. As the Court of Appeals for the Second Circuit explained, the purpose of Section 10(b) and Rule 10b-5 is "to make sure that buyers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the buyer to be inadequate or for a consideration known to the buyer not to be what it purports to be." *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d at 943.

Congress affirmatively excluded stockbroker margin loans from coverage of the Truth in Lending Act. See S. Rep. No. 392, 90th Cong., 1st Sess. 9.[5] Instead, Congress directed the Commission to require stockbrokers to make the same disclosures as called for under the statute. *Ibid.*[6] The court of appeals declined to honor Congress' intention, as expressed in the Truth in Lending Act, not to provide a private right of action for margin loans. 764 F.2d at 948 n.14 (17a n.14). In so doing it disregarded the teaching of this Court in *Cort v. Ash,* 422 U.S. 66, 82 (1975), that "an explicit purpose" expressed by Congress to deny a private right of action is dispositive of the question. Where, as here, Congress removed margin loans from the private right of action it created in a statute, the court of appeals should have given conclusive weight to Congress' "explicit purpose" (422 U.S. at 82) to deny a private right of action. The court of appeals' decision that "an inquiry into 'congressional intent' . . . would not appear appropriate" (764 F.2d at 947, 16a) cannot be reconciled with, and indeed is flatly in derogation of, the teaching of this Court in *Cort v. Ash.*

Creation of a private right of action under Rule 10b-16 will confront the district courts with the insoluble problem of defining the injury suffered as a proximate result of the violation. The court of appeals held that an implied right of action exists that permits respondent to sue for damages proximately caused by petitioner's alleged failure to disclose the terms and conditions of a loan of money. Under Section 28(a) of the Securities Exchange Act, 15 U.S.C. § 78bb(a), a plaintiff's recovery in a private civil

---

5. The Senate Report stated: "[S]tockbroker margin loans to investors would be exempt from the disclosure requirements of the bill." *Id.* at 9.

6. The Senate Report stated: "In recommending an exemption for stockbroker margin loans in the bill, the committee intends for the SEC to require substantially similar disclosure by regulation as soon as it is possible to issue such regulations." *Id.* at 9.

action for violation of the federal securities laws is limited to "actual damages." *But there is no way to define the "actual damages" respondent has suffered in this case.* Respondent's complaint does not define the damages in this case (39a, 43a) and, strikingly, the opinions of both the district court (575 F.Supp. at 274, 30a-31a) and the court of appeals (764 F.2d at 946-950, 14a-21a) are completely silent on the point. The Court of Appeals for the Ninth Circuit likewise avoided the question in *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 536-539. Respondent, the district court, and the court of appeals did not define the injury that respondent suffered because they could not: the "injury" does not exist. Yet without a definition of the injury respondent suffered, the provision of a private right of action to sue for money damages is meaningless.[7]

The inability of the court of appeals, the district court, and respondent to define an injury is not surprising. Congress confronted the identical problem when it passed the Truth in Lending Act. It recognized that "[m]ost Truth-in-Lending violations do not involve actual damages." *Watkins v. Simmons and Clark, Inc.*, 618 F.2d 398, 403 (6th Cir. 1980) (quoting the Senate Committee Report in connection with the 1974 amendments to the Truth in Lending Act).[8] The impossibility of fashioning

---

7. In *Haas v. Wiebold Stores, Inc.*, 725 F.2d 71 (7th Cir. 1984), which the court below incorrectly cited for the proposition that a private right of action exists under SEC Rule 14a-9 (764 F.2d at 947, 17a), the court of appeals recognized that implication of a private right of action *requires* the court to define the damages proximately caused by a violation of the statute or rule from which the right of action is implied. There, the court of appeals defined the damages proximately caused by a violation of SEC Rule 14a-7 as "the expenses of preparing proxy materials that must be discarded." 725 F.2d at 74.

8. As one district court explained:

> "[T]he Senate Committee report on the 1974 amendments [to the Truth in Lending Act] mentions several times the

(Cont'd)

a formula for "actual damages" for a violation of the Truth in Lending Act persuaded Congress to include in the statute a detailed statutory damage formula that is *not remedial, but penal.* See S. Rep. No. 392, 90th Cong., 1st Sess. 9.[9] A creditor extending credit in violation of the act is required to pay, *inter alia,* statutory penal damages (15 U.S.C. § 1640(a)(2)(A)(i)) and 25% of certain monthly payments (15 U.S.C. § 1640(a)(2)(A)(ii)) (49a). Congress intended these penal provisions — which are unrelated to actual damages — to encourage disclosure. *Watkins v. Simmons and Clark, Inc.,* 618 F.2d at 403. Since "[m]ost Truth in Lending Act violations do not involve actual damages" (618 F. 2d at 403), absent statutory penalties a creditor could ignore the mandate of the statute with impunity. By contrast, there is no need for private litigation to enforce Rule 10b-16. To the contrary, in

---

(Cont'd)

> difficulty of proving or computing actual damages in a Truth in Lending case. This difficulty seems to have been the impetus for establishing a scheme of statutory damages, and it seems likely that if actual damages could be computed by a simple formula, no statutory damage provision would have been necessary." *McCoy v. Salem Mortgage Co.,* 74 F.R.D. 8, 12 (E.D. Mich. 1976).

Accord, *Clausen v. Beneficial Financial Co. of Berkeley,* 423 F.Supp. 985, 990 (N.D. Cal. 1976).

9. The Senate Report stated:

> "The enforcement of the bill would be accomplished largely through the institution of civil actions authorized under section 7 of the bill. Any creditor who fails to disclose the required information would be subject to a civil action with a penalty of twice the finance charge. However, the minimum penalty would be $100 and the maximum penalty would be $1,000. The committee has not recommended investigative or enforcement machinery at the Federal level, largely on the assumption that the civil penalty section will secure substantial compliance with the act."

explicitly excluding margin loans from the Truth in Lending Act, Congress directed the Commission to require broker-dealers to make the same disclosures as those it contemporaneously mandated in the statute. See footnote 6, *ante*. The Commission, which comprehensively and effectively regulates broker-dealers, has done so.

Creation of a private right of action under Rule 10b-16 will also create enormous confusion as to the proper measurement of damages. Because under the federal securities laws a plaintiff's recovery is limited to "actual damages," 15 U.S.C. § 78bb(a), every court in which a private Rule 10b-16 action is filed will be called on, not only to define the injury the plaintiff actually suffered, but to determine the correct measurement of damages. And they will do so without appellate guidance, since neither court of appeals that recognized a private right of action under Rule 10b-16 could define the injury the right of action was meant to redress or the proper measurement of damages applicable thereto.

CONCLUSION

The court of appeals' decision to imply a private right of action without inquiry into Congressional intent is in flat derogation of this Court's decision in *Touche Ross & Co. v. Redington,* that the "central inquiry" in such a situation must be to ascertain the intent of Congress. Examination of the intention of Congress demonstrates that the court of appeals' recognition of an implied private right of action under Rule 10b-16 is improper. Recognition of such a private right of action will create inordinately vexing problems in defining the injury for which redress is sought and in measuring the amount of damages a plaintiff has suffered as a proximate result of the rule's violation. Review by this Court is warranted to rectify the court of appeals' disregard of the decisions of this Court.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

LEONARD BARRACK
DANIEL E. BACINE
SAMUEL R. SIMON
Attorneys for Petitioner

Dated: September 10, 1985

OPINION OF COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NOS. 84-5401 and 84-5427

LAURA ANGELASTRO, on behalf of herself
and all others similarly situated,
Appellant in 84-5427

v.

PRUDENTIAL-BACHE SECURITIES, INC.
and BACHE HALSEY STUART SHIELDS, INC.,
Appellants in 84-5401

On Appeal from the
United States District Court
for the District of New Jersey
(C.A. No. 83-1270)

Argued February 26, 1985

Before: ADAMS, WEIS and WISDOM,*
Circuit Judges

(Filed June 12, 1985)

RICHARD D. GREENFIELD
ROBERT P. FRUTKIN
SUSAN SCHNEIDER THOMAS (Argued)
Greenfield, Chimicles & Lewis
Haverford, Pennsylvania
Attorneys for Appellant
in 84-5427

---

* The Honorable John Minor Wisdom, United States Court of Appeals for the Fifth Circuit, sitting by designation.

LEONARD BARRACK
DANIEL E. BACINE (Argued)
SAMUEL R. SIMON
Barrack, Rodos & Bacine
Philadelphia, Pennsylvania
Attorneys for Appellees
in 84-5401

DANIEL L. GOELZER
General Counsel
JACOB H. STILLMAN
Associate General Counsel
DAVID A. SIRIGNANO (Argued)
Assistant General Counsel
GERARD S. CITERA
GORDON K. FULLER
Attorneys
Washington, D.C.
Attorneys for the Securities and Exchange Commission, Amicus Curiae
Of Counsel
PAUL GONSON, Solicitor

OPINION OF THE COURT

ADAMS, *Circuit Judge.*

This appeal presents the issue whether alleged misrepresentations and nondisclosures by a brokerage firm regarding the credit terms of a margin account fall within the ambit of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982) (Exchange Act), and two rules promulgated thereunder by the Securities and Exchange Commission (SEC). The district court concluded that even if proved such deceptive practices could not be deemed "in connection

with" the purchase or sale of a security, and dismissed plaintiff's claims under section 10(b) of the Exchange Act and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1984); it did determine, however, that plaintiff could maintain a private action under Rule 10b-16, 17 C.F.R. § 240.10b-16 (1984). We agree that a private action may be brought under Rule 10b-16, and therefore will affirm the district court's ruling on that issue. However, because we conclude that misrepresentations and nondisclosures regarding a margin account may be "in connection with" the purchase or sale of a security, we will reverse the order dismissing the section 10(b) and Rule 10b-5 claims.

I.

Laura Angelastro, the plaintiff, maintained a margin account with Bache Halsey Stuart Shields, Inc., a national securities brokerage firm. On April 4, 1983, Angelastro filed suit in district court on behalf of herself and all others who purchased securities from 1977-82[1] through margin accounts maintained by defendant Prudential-Bache Securities, Inc., or its corporate predecessor, Bache Halsey Stuart Shield, Inc.[2] The complaint asserted that Bache misrepresented and failed to disclose material information regarding the interest rates applicable to its margin accounts, purportedly in violation of section 10(b) of the Exchange Act and Rules 10b-5 and 10b-16.

Defendants moved, pursuant to Fed. R. Civ. P. 12b(6), to dismiss the complaint for failure to state a claim upon which relief could be granted. Holding that the activities alleged in the complaint were not undertaken "in connection with" the purchase or sale of any securities, the district court dismissed

---

1. The district court has not yet ruled on the issue of class certification; accordingly we will consider Angelastro as the sole plaintiff for purposes of this opinion.

2. Defendants will be referred to collectively as Bache.

Angelastro's Rule 10b-5 claim. *Angelastro v. Prudential-Bache Securities, Inc.*, 575 F. Supp. 270 (D.N.J. 1983). The court rejected, however, defendants' argument that no private right of action exists under Rule 10b-16, and held that the complaint did state a claim under that rule.

The district court certified its decisions on both Rules 10b-5 and 10b-16 for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (1982). In June of 1984, we granted the parties' motions for certification. This interlocutory appeal is limited to two issues: (1) whether alleged fraud regarding the credit terms of a margin account may be "in connection with" the purchase and sale of securities within the meaning of section 10(b) of the Exchange Act and the Commission rules promulgated thereunder; and (2) whether a private right of action exists under Rule 10b-16.

II.

Section 10(b)[3] and Rule 10b-5,[4] the basic anti-fraud provision promulgated thereunder, interdict the

---

3. Section 10(b) of the Exchange Act provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1982).

4. Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by

misrepresentation or omission of material facts in connection with the purchase or sale of any securities. A Rule 10b-5 claim requires, *inter alia*, that the misrepresentation be made "in connection with" the purchase or sale of a security. *See Ketchum v. Green*, 557 F.2d 1022, 1025 (3d Cir.), *cert. denied*, 434 U.S. 940 (1977).[5] The purpose underlying section 10(b) and the rules adopted under it is to insure that investors obtain disclosure of material facts in connection with their investment decisions regarding the purchase or sale of securities. *See Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972). Rule 10b-5 claims typically involve alleged misrepresentations with respect to the merits of a particular security. For example, nondisclosure of insider information concerning the value of securities states a claim under

---

the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1984).

5. Other requirements for a 10b-5 claim are (1) a material misrepresentation; (2) a purchase or sale of a security; and (3) scienter on the part of the defendant who made the misrepresentations. *See e.g.*, Ketchum v. Green, 557 F.2d 1022, 1025 (3d Cir.), *cert. denied*, 434 U.S. 940 (1977); Jaksich v. Thomson McKinnon Securities, Inc., 582 F. Supp. 485, 493 (S.D.N.Y. 1984).

the rule. *See, e.g., Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1974); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (in banc), *cert. denied*, 394 U.S. 976 (1969). Such a misrepresentation is obviously made "in connection with" the stock that is subsequently sold or purchased.

Rule 10b-5 also encompasses misrepresentations beyond those implicating the investment value of a particular security. The Supreme Court has declared that section 10(b) must be read "flexibly, not technically and restrictively." *Superintendent of Insurance v. Bankers Life and Casualty Co.*, 404 U.S. 6, 12 (1971). In *Bankers Life*, the Supreme Court permitted a section 10(b) claim to proceed in an action concerning the misappropriation of bond sale proceeds to cover "rubber" checks previously used to purchase securities. 404 U.S. at 6. In the course of its discussion, the Court interpreted the "in connection with" language of section 10(b) to require that the plaintiff has "suffered an injury as a result of deceptive practices touching [the purchase or] sale of securities." *Id.* at 12-13. This Court has construed the "touching" requirement as mandating that there be some "causal connection between the alleged fraud and the purchase or sale" of a security. *Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187, 194 (3d Cir. 1976); *see also Ketchum v. Green*, 557 F.2d at 1028; *Liberty National Insurance Holding Co. v. Charter Co.*, 734 F.2d 545, 555 (11th Cir. 1984) (noting that the "in connection with" element requires a causal relationship between the claimed deception and a subsequent purchase or sale).

In keeping with the Supreme Court's statement that the "in connection with" language be read broadly, many courts have found the requisite causal nexus in situations involving the course of dealing in securities. *Cf. Jaksich v. Thomson McKinnon Securities, Inc.*, 582 F. Supp. 485, 494 (S.D.N.Y. 1984) (fraud directly

related to the trading process meets the "in connection with" requirement); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) ("a 10b-5 action will survive even though the fraudulent scheme or device is unrelated to 'investment value'"). For example, many courts have found allegations of churning[6] to state a claim under Rule 10b-5. *See, e.g., Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1368 (7th Cir. 1983); *Thompson v. Smith Barney, Harris Upham & Co.*, 709 F.2d 1413 (11th Cir. 1983); *In re Catanella and E.F. Hutton and Co.*, 583 F. Supp. 1388, 1405, 1410-11 (E.D. Pa. 1984). The fraud present in a churning operation does not concern the merits of the individual securities bought and sold but rather the excessiveness of the number of transactions in the aggregate.

Similarly, several courts have found a broker's failure to explain the risks of trading on margin to be actionable under Rule 10b-5. For example, in *Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615, 619 (9th Cir. 1981), the Ninth Circuit rejected the defendant's argument that fraud "in connection with the method of financing the purchases of securities, not with the purchase itself" fell outside the coverage of Rule 10b-5. The court held that misrepresentation of the risks of buying securities on margin in a declining market may be considered fraud "in connection with" the purchase of securities." *Id.; see also Catanella*, 583 F. Supp. at 1413; *Yancoski v. E.F. Hutton & Co.*, 581 F. Supp. 88, 92 (E.D. Pa. 1983). Many other types of fraud involving the trading process, rather than the investment value of a

---

6. Churning occurs when a securities broker buys and sells securities without regard to the customer's investment objectives, in order to generate commissions. *See* Thompson v. Smith Barney, Harris Upham & Co., Inc., 709 F.2d 1413, 1416 (11th Cir. 1983).

particular security have also been found to come within the scope of section 10(b) and Rule 10b-5. *See, e.g., McGrath v. Zenith Radio Corp.*, 651 F.2d 458 (7th Cir.) (inducement to tender stocks by false promise of future employment), *cert. denied*, 454 U.S. 835 (1981); *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.) (misrepresentation that broker-trainee was stockbroker and portfolio management specialist), *cert. denied*, 449 U.S. 1011 (1980).

In *Steinberg v. Shearson Hayden Stone, Inc.*, 546 F. Supp. 699 (D. Del. 1982), the court was confronted with precisely the question at issue here. There the court held that a claim of failure to disclose material facts regarding credit terms of a margin account is actionable under Rule 10b-5. Although not discussed explicitly, the court necessarily found misrepresentations of the credit terms of a margin account to be "in connection with" the purchase or sale of a security. *See also Establissement Tomis v. Shearson Hayden Stone, Inc.*, 459 F. Supp. 1355, 1361-63 (S.D.N.Y. 1978) (suggesting that a 10b-5 action can be maintained for various margin violations).

As noted, this Court has construed the "in connection with" language as requiring some causal connection between the alleged misrepresentation and the harm incurred when a security is purchased or sold. *Ketchum v. Green*, 557 F.2d 1022, 1028 (3d Cir.), *cert. denied*, 434 US. 940 (1977); *Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187, 194 (3d Cir. 1976). In Paragraph 16 of her complaint, Angelastro asserted that defendants failed to disclose fully and accurately to their margin customers material information such as (1) "the specific interest rate that would be charged in connection with each such purchase"; (2) "the formula pursuant to which interest charges were assessed"; (3) "that all amounts credited to their customers' accounts would not be considered in computing daily interest

charges to be assessed against those margin accounts"; (4) "that increases in the market value of the underlying securities in connection with which credit was extended by Bache would not be considered in determining the extent of credit or in computing interest charges to be assessed against their customers' margin accounts"; and (5) "that the interest rates available to its customers who maintained margin accounts were variable, the factors upon which the variable rates were determined and the procedures by which its customers could obtain a variable interest rate." Plaintiff further avers that these misrepresentations induced her "to purchase various securities through Bache" in margin accounts. Complaint ¶¶ 15, 17.

For purposes of a Fed. R. Civ. P. 12b(6) motion to dismiss for failure to state a claim upon which relief can be granted, we must accept all well pleaded allegations in the complaint as true and view them in the light most favorable to plaintiff. *Rogin v. Bensalem Township*, 616 F.2d 680, 685 (3d Cir. 1980), *cert. denied*, 450 U.S. 1029 (1981); *Bogosian v. Gulf Oil Corp.*, 561 F.2d 434, 444 (3d Cir. 1977), *cert. denied*, *434 U.S. 1086 (1978). We may not dismiss the complaint unless the plaintiff can prove no set of facts which would entitle her to relief. Conley v. Gibson*, 355 U.S. 41, 45-46 (1957); *accord Bogosian*, 561 F.2d at 444.

Like churning, concealment or misrepresentation of interest terms relating to a margin account does not affect the investment value of a particular security, but rather the course of dealing in securities. Accordingly, under the standard announced in *Tully* and *Ketchum*, Angelastro has pleaded a sufficient causal connection between the purported fraudulent concealment and her purchases of securities on margin to meet the "in connection with" requirement of section 10(b) of the

Exchange Act. *See Jaksich*, 582 F. Supp. at 494. The Supreme Court has emphasized that the federal securities laws were designed "'to achieve a high standard of business ethics ... *in every facet of the securities industry.*'" *United States v. Naftalin*, 441 U.S. 768, 775 (1979) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-87 (1963)) (emphasis added in *Naftalin*). Holding that the concealment of credit terms of a margin account falls within the purview of Rule 10b-5 comports with this policy. *Accord Steinberg*, 456 F. Supp. at 700-01.

Investors maintain margin accounts with brokerage firms for the very purpose of trading in securities.[7] They need accurate information regarding the credit terms of their margin accounts in order that they may evaluate the desirability of purchasing securities on margin. The amount required to service the debt in a margin account may very well affect the profitability of such trading. Moreover, disclosure of the rate and method of calculation of interest payments is also critical in order that an investor will not become overextended, and then be forced to liquidate, possibly at substantial losses, all or part of his or her margin holdings to meet a margin call. We therefore reject Bache's assertion that, as a matter of law, plaintiff could prove no set of facts to demonstrate a connection between the credit terms of a margin account and her decision to purchase securities on margin. If Angelastro can establish what she sets forth in her complaint -- that defendants' misstatements and nondisclosure of material terms induced her to

---

7. This case does not involve the hypothetical case posited by defendants in which an investor borrows from his margin account for other purposes and pledges securities as collateral.

purchase certain securities to her financial detriment -- she may very well be entitled to some recovery.[8]

One basis for the district court's rejection of plaintiff's Rule 10b-5 claim was a concern that if "brokerage firms were liable under 10b-5 for margin violations, it would logically follow that other lending institutions which made credit available for use in stock market transactions could also be liable under 10b-5 on their misrepresentations." 575 F. Supp. at 273. We agree that there is a danger in construing the "in connection with" requirement so broadly that virtually any type of misconduct related to a securities transaction even in the most tenuous or tangential way might be claimed to give rise to a federal securities law violation. The Supreme Court was aware of potential overextensions of section 10 when it established the scope of the "in connection with" requirement in *Bankers Life*. It observed that Congress "did not seek to regulate transactions which constitute no more than internal corporate mismanagement." 404 U.S. at 12. To avoid the pitfalls of such overreaching, we noted in *Ketchum*, 557 F.2d at 1027, that courts should adopt a case-by-case approach for determining the proper

---

8. In one sense defendants appear to be arguing that a misrepresentation of the credit terms of a margin account cannot be material to an investor's decision whether to purchase securities. We are unable to say that, as a matter of law, a reasonable investor would not rely on such a consideration when deciding whether to purchase securities in the first place and if so whether to purchase them on margin. *See* Healey v. Catalyst Recovery of Pennsylvania, Inc., 616 F.2d 641, 647 (3d Cir. 1980) (defining materiality as "'a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder'") (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

scope of the "in connection with" requirement. *Id.*; *see also Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 595 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974).

Thus the in terrorem argument advanced by defendants and accepted by the district court is not persuasive. Our holding that the misrepresentations alleged by Angelastro regarding her margin account are cognizable under Rule 10b-5 does not mean that every loan transaction in which a pledge[9] of securities is involved or every bank loan for the purpose of purchasing securities is necessarily within the purview of section 10(b). We decide only the issue certified to us by the district court.[10]

Accordingly, defendants' reliance on the Second Circuit's decision in *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 105 S. Ct. 253 (1984), is not well founded. In that case, Frigitemp Corporation arranged a bank loan for Elsters Corporation, its subsidiary. As part of the agreement, Frigitemp guaranteed Elsters' promissory note and pledged as security 100% of the subsidiary's stock. After Frigitemp filed a bankruptcy petition, the lending banks instituted a Rule 10b-5 action against Frigitemp's accountant. The banks alleged that they had relied on falsified accounting statements when they decided to make the loan. Because the pledge of Elsters' stock was found to be totally unrelated to the allegedly false financial statements of Frigitemp, the

---

9. A pledge of securities can be a "sale" for purposes of the securities laws. Rubin v. United States, 449 U.S. 424, 428-30 (1981).

10. Because we hold that plaintiff's purchase of securities meets the "in connection with" requirement, we do not reach Angelastro's alternative theory that her purchase of securities on margin constitutes a pledge (sale) that satisfies the "in connection with" requirement.

Second Circuit held that the misrepresentations were not made in connection with the pledge of Elsters' stock. 726 F.2d at 944-45. There was no allegation of fraud regarding the stock, and the pledge was "merely an incident in a transaction not otherwise involving the purchase or sale of securities." *Id.* at 944 n. 24.

The Second Circuit was concerned that every bank loan partially secured by the pledge of stock might fall within the scope of section 10(b). We agree that too broad an interpretation of § 10(b) is unwarranted, but our decision here is not inconsistent with *Chemical Bank*. Misrepresentation of the credit terms of a margin account, which is what purportedly occurred here, is a different situation from that in *Chemical Bank*, and clearly meets the "in connection with" requirements.

Finally, we note that affirming the district court's decision regarding Rule 10b-5 would cast doubt upon the validity of Rule 10b-16.[11] Although the district court

---

11. Rule 10b-16 provides (in relevant part) that

> (a) It shall be unlawful for any broker or dealer to extend credit, directly or indirectly, to any customer in connection with any securities transaction unless such broker or dealer has established procedures to assure that each customer
>
> (1) is given or sent at the time of opening the account, a written statement or statements disclosing (i) the conditions under which an interest charge will be imposed; (ii) the annual rate or rates of interest that can be imposed; (iii) the method of computing interest; (iv) if rates of interest are subject to change without prior notice, the specific conditions under which they can be changed; (v) the method of determining the debit balance or balances on which interest is to be charged and whether credit is to be given for credit balances in cash accounts; (vi) what other charges resulting from the extension of credit, if any, will be made and under what conditions; and (vii) the nature of any interest or lien

dismissed the Rule 10b-5 claim because of a perceived failure to meet the "in connection with" requirement, it nevertheless permitted the Rule 10b-16 claim to proceed. Rule 10b-16, however, like 10b-5, was promulgated by the SEC pursuant to authority granted to the agency by Congress in section 10(b) of the Exchange Act. Since section 10(b) contains the "in connection with" language, all rules stemming from it must also contain this limitation. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976) (agency's rulemaking power cannot exceed power granted by Congress in the enabling statute). Indeed, Rule 10b-16 itself requires certain disclosures regarding credit terms of margin accounts "in connection with" a securities transaction; to hold that as a matter of law a misrepresentation regarding margin credit terms does not meet the "in connection with" requirement would appear to invalidate Rule 10b-16. SEC determinations regarding securities regulations are entitled to deference and we should not nullify an entire rule without good reason. *See Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 537 (9th Cir. 1984).

III.

A.

In its cross appeal, Bache requests us to overturn the district court's ruling that plaintiff may bring suit under Rule 10b-16. Since neither section 10(b) of the Exchange Act nor Rule 10b-16 explicitly provide for a private right of action, we must determine whether

---

retained by the broker or dealer in the security or other property held as collateral and the conditions under which additional collateral can be required ...

17 C.F.R. § 240.10b-16 (1984).

such a right may be implied from the statute and the rule.[12]

Much has been written, particularly by the Supreme Court, regarding how and when to find an implied right of action under a statute. *See, e.g., Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979); *Cort v. Ash*, 422 U.S. 66 (1975). This case is somewhat unusual, however, because we must determine whether to imply a private right of action from an SEC rule, and only indirectly from the enabling statute. Thus the mode of statutory analysis developed by the Supreme Court in *Cort v. Ash*, 422 U.S. 66 (1975), and refined in subsequent decisions is not completely sufficient for the present case.

Deciding whether to imply a private right of action from an agency rule requires a two-fold inquiry. First, it is necessary to ascertain whether the statute under which the rule was promulgated properly permits the

---

12. The only two courts of appeals that have considered this question have found an implied right of action under Rule 10b-16. *See* Robertson v. Dean Witter Reynolds, Inc., 749 F.2d 530 (9th Cir. 1984); Liang v. Dean Witter & Co., 540 F.2d 1107 (D.C. Cir. 1976); *cf.* Zerman v. Ball, 735 F.2d 15 (2d Cir. 1984) (raising but not reaching the question). In addition, a majority of the district courts confronting the issue have also found a private right of action under Rule 10b-16. *See* Slomiak v. Bear Stearns & Co., 597 F. Supp. 676, 677-81 (S.D.N.Y. 1984); Abeles v. Oppenheimer & Co., 597 F. Supp. 532, 535-36 (N.D. Ill. 1983); Haynes v. Anderson & Strudwick, Inc., 508 F. Supp. 1303, 1318-21 (E.D. Va. 1981). *But see* Establissement Tomis v. Shearson Hayden Stone, Inc., 459 F. Supp. 1355, 1361 (S.D.N.Y. 1978); Furer v. Paine, Webber, Jackson & Curtis, Inc., [1982] Fed. Sec. L. Rep. (CCH) ¶ 98,701 (C.D. Cal. 1982).

implication of a private right of action. To this determination, the method of analysis developed by the Supreme Court is fully applicable. If under *Cort v. Ash* and its progeny, a court finds that Congress did not intend the statute to be enforced by private actions, then the inquiry is concluded. No private right of action may be implied in such a situation since an agency's rulemaking power cannot exceed the authority granted to it by Congress. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976); 2 K. Davis, *Administrative Law Treatise* § 7.8 (1979).

If the enabling statute permits a private right of action, a second inquiry must then be made: whether a private right of action should be implied from the agency rule at issue. *See Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 534 (9th Cir. 1984); *Jablon v. Dean Witter & Co.*, 614 F.2d 677, 679 (9th Cir. 1980). At this stage it is necessary to determine: (1) whether the agency rule is properly within the scope of the enabling statute, and (2) whether implying a private right of action will further the purpose of the enabling statute. *See, e.g., Robertson*, 749 F.2d at 536-39; *Abeles v. Oppenheimer*, 597 F. Supp. 532, 536 (N.D. Ill. 1983). Where the enabling statute authorizes an implied right of action, courts should permit private suits under agency rules within the scope of the enabling statute if doing so is not at variance with the purpose of the statute. As one commentator has stated, if Congress intended to permit private actions for violations of the statute, "it would be anomalous to preclude private parties from suing under the rules that impart meaning to the statute." Note, *Private Causes of Action Under SEC Rule 14e-3*, 51 Geo. Wash. L. Rev. 290, 303 (1983).

At this second stage, an inquiry into "congressional intent" underlying an agency rule would not appear appropriate, because a court reaches

this second stage only after it has already concluded that Congress intended the statute to give rise to private actions. Therefore, the second stage inquiry should focus on whether granting private parties the ability to bring suit under the rule will further the substantive purposes of the enabling statute. *See Robertson*, 749 F.2d at 537; *see also Haas v. Wieboldt Stores, Inc.*, 725 F.2d 71, 73-74 (7th Cir. 1984) (finding private right of action under SEC Rule 14a-9). Every rule that is promulgated under a statute providing for a private right of action will not automatically create such a right; the two-stage inquiry must be undertaken.[13]

B.

We now apply the foregoing analytical framework to the present case. The first step in the inquiry is relatively simple. Since the seminal case of *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), courts have found an implied private right of action under section 10(b) of the Exchange Act, the statute under which Rule 10b-16 was promulgated.[14] The

---

13. In addition, the fact that a given rule impliedly authorizes a private action does not definitely determine whether a private action is proper in every suit brought under the rule. Certain claims may be found not to fall within the substantive ambit of the rule. For example, it is now beyond dispute that a private right of action exists under Rule 10b-5. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 380 & n.10 (1983); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975). Nevertheless, the Supreme Court has delimited the scope of actions under the rule, such as by requiring the plaintiff to be a purchaser or seller of securities. *See Blue Chip*, 421 U.S. at 723. Whether Angelastro's theory of recovery meets the "in connection with" requirement of section 10(b) is a similar substantive question.

14. In determining whether a private right of action exists under Rule 10b-16, a number of courts have mistakenly looked to the

Supreme Court confirmed the existence of private actions under the statute in 1971. *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under § 10(b)."). Despite the recent trend towards curtailing the scope of implied rights of action, the Supreme Court has continually reaffirmed that "[t]he existence of this implied remedy is simply beyond peradventure." *Huddleston*, 459 U.S. at 380; *see also Wachovia Bank & Trust Co. v. National Student Marketing Corp.*, 650 F.2d 342, 351-53 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981) (private right of action under section 10(b) survives recent Supreme Court contractions of implied right of action doctrine).

Regarding the second stage of the inquiry, Bache contends that a private right of action may not be implied under Rule 10b-16 because the Commission

---

intention of Congress when it enacted the Truth-in-Lending Act, 15 U.S.C. §§ 1601 *et seq.* (1982) (TILA). In 1968, when Congress passed TILA -- which requires disclosure of credit terms in loan transactions -- it expressly exempted securities accounts from the Act's coverage, 15 U.S.C. § 1603(2), and declared its intention that the SEC adopt a rule requiring substantially similar disclosure for securities accounts. *See* S. Rep. No. 392, 90th Cong., 1st Sess. 9 (1967). Thereafter, the Commission adopted Rule 10b-16 as an analogue to TILA for margin accounts. *See* Securities Exchange Act Release No. 34-8773, 34 F.R. 19717 (1969). Because TILA explicitly creates a private right of action, the court in *Haynes*, 508 F. Supp. at 1318-21, decided that Congress must have intended a private right of action for Rule 10b-16. The court in *Furer*, [1982] Fed. Sec. L. Rep. (CCH) ¶ 98,701 at 93,495, drew the opposite conclusion from the fact that Congress did not include securities accounts within TILA. Regardless of which inference is proper, Congress' intent to permit private rights of action must stem from § 10(b) of the Exchange Act, the provision which granted the Commission the power to adopt the rule, not from TILA. *See Robertson*, 949 F.2d at 535.

exceeded its authority when it adopted the rule. Bache characterizes 10b-16 as a rule primarily regulating the conduct of broker-dealers or the granting of credit and as being totally collateral to the purposes of section 10(b). Defendants argue, therefore, that the rule should have been promulgated under section 15 of the Exchange Act, 15 U.S.C. § 78o (registration and regulation of brokers and dealers) or under section 7 of the Exchange Act, 15 U.S.C. § 78g (margin requirements). These sections, Bache maintains, do not provide private rights of action.

We need not ascertain whether a private right of action is authorized by sections 7 or 15 of the Exchange Act, or indeed whether Rule 10b-16 properly could have been promulgated under one of those sections. The Supreme Court has recognized that there is a certain amount of overlap among the various provisions of the Exchange Act and the other federal securities laws; consequently, a particular practice may be authorized or proscribed by more than one section. *See Huddleston*, 459 U.S. at 382-83 ("no reason to carve an exception to § 10(b) ... just because the same conduct may also be actionable under § 11"); *United States v. Naftalin*, 441 U.S. 768, 778 (1979) ("'[t]he fact that there may well be some overlap is neither unusual nor unfortunate'") (quoting *SEC v. National Securities, Inc.*, 393 U.S. 453, 468 (1969)). Thus it is of no moment that Rule 10b-16 touches conduct that might also have been regulated under other sections of the Exchange Act. The only relevant inquiry is whether the rule is within the scope of authority granted to the Commission under section 10(b), which directs the SEC to prescribe anti-fraud rules "necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). We conclude that it is.

The fundamental purpose of the Exchange Act is to promote the "full and fair disclosure" of material

information in securities transactions. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-78 (1977); *see also Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972) (purpose of the Act is "'to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* ....'") (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963)). Within the legislative schema enacted by Congress to accomplish this goal, section 10(b) is the "catch-all" anti-fraud provision. *Huddleston*, 459 U.S. at 382; *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980). Section 10(b) accomplishes this task by delegating to the Commission the duty of adopting rules that proscribe "any manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b). The purpose of this section is to protect the public at large through the better operation of the securities market, and in particular to protect investors who purchase or sell securities, through full disclosure of all material information.

We agree with the Ninth Circuit that failure to disclose the credit terms of a margin account can constitute a "manipulative or deceptive device or artifice" within the meaning of the statute. *See Robertson*, 749 F.2d at 538-39; *see also Liang*, 540 F.2d at 1113 n.25; *Abeles v. Oppenheimer*, 597 F. Supp. at 536. The credit terms charged by a brokerage firm may be of substantial significance in an investor's decision whether to purchase securities either on margin or at all. Because the cost of margin payments, as well as the method of their calculation, may cause an investor to purchase more securities than he or she otherwise might buy and may also increase the risks of trading on margin, nondisclosure of such information might serve as a fraudulent or deceptive device on investors. The rule therefore serves to protect investors, and thus we cannot say that the

Commission exceeded its authority when it adopted a provision requiring disclosure of such information.

This brings us to the crux of the second inquiry: whether permitting a private right of action furthers the purposes of section 10(b). To some extent this question has already been answered in the affirmative by the determination that Rule 10b-16 is within the statutory grant of authority. As with Rule 10b-5, allowing a private right of action under Rule 10b-16 will advance the statutory goals of promoting full disclosure of material information and of protecting investors from fraudulent practices.[15] In the present case, Angelastro alleges that Bache failed to divulge to her all the credit terms of her margin account. As a result of this concealment, plaintiff alleges that she was misled into purchasing securities that she otherwise would not have bought. Permitting private plaintiffs who have been harmed by a violation of Rule 10b-16 to bring private damages suits furthers the goal of section 10(b). Such actions will protect investors from improper nondisclosures and at the same time encourage brokerage firms to adhere to the rule's prescriptions.

IV.

The district court's decision that plaintiff may proceed with her complaint under Rule 10b-16 will be

---

15. In contrast, the court in Siedman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 465 F. Supp. 1233, 1237 (S.D.N.Y. 1979), refused to imply a private right of action under Rule 15c3-3(b) because that rule merely provides a standard of conduct to be followed by a broker-dealer for the purpose of insuring the orderly operation of the exchange. Unlike Rule 10b-5, Rule 15c3-3(b) is not aimed at preventing fraud on investors. *Cf.* Warren v. Bokum Resources Corp., 433 F. Supp. 1360, 1366-68 (D.N.M. 1977) (finding private right of action under Rule 10b-13).

affirmed. In addition, the order of the district court dismissing plaintiff's claim under Rule 10b-5 will be reversed and the case remanded for proceedings consistent with this opinion.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

DISTRICT COURT OPINION AND ORDER

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action No. 83-1270

LAURA ANGELASTRO, on behalf of herself and all others similarly situated,

Plaintiff,

v.

PRUDENTIAL-BACHE SECURITIES, INC., and BACHE HALSEY STUART SHIELDS, INC.,

Defendants.

OPINION

APPEARANCES:

Alan Fellheimer, Esquire
Fellheimer, Eichen & Goodman
Sentry Office Building
216 Haddon Avenue, Suite 520
Westmont, New Jersey 08108

Richard D. Greenfield, Esquire
Robert P. Frutkin, Esquire
David B. Zlotnick, Esquire
Greenfield & Chimicles
110 Montgomery Avenue
Bala Cynwyd, Pennsylvania 19004
Attorneys for Plaintiff

Opinion and Order

Philip S. Fuoco, Esquire
211 Kings Highway East
P.O. Box 1006
Haddonfield, New Jersey 08033

Leonard Barrack, Esquire
Daniel E. Bacine, Esquire
Barrack, Rodos & Bacine
2000 Market Street
Philadelphia, Pennsylvania 19103
Attorneys for Defendants

GERRY, District Judge

The plaintiff is seeking to maintain this suit, in which violations of federal securities laws are alleged, as a class action. The parties have agreed, however, to put off the plaintiff's motion for class certification until after the court has reached a decision on the motion to dismiss.

The complaint alleges violations of Section 10(b) of the Securities Exchange Act of 1934 and Rules 10b-5 and 10b-16 promulgated thereunder, the "purpose and effect of these violations to induce plaintiff and other class members to purchase various securities through Bache and to make such purchases for excessive consideration." Specifically, paragraph 16 of the complaint charges that the defendants *inter alia*: failed to fully and accurately disclose to their margin customers the interest rates that would be charged on margin accounts in connection with the purchase of securities; failed to disclose the formula by which interest rates would be assessed; failed to disclose that increases in the market value of underlying securities in connection with which credit was extended would not be considered in determining

the extent of credit or in calculating interest charges to be assessed against margin accounts; failed to disclose that interest rates on margin accounts were variable, and that alternate and lower interest rates were available; and failed to adequately train and supervise their employees to insure that information on credit terms was fully disseminated. As a consequence of these nondisclosures, the plaintiff claims that the investing public has been mislead, that securities were purchased for excessive consideration, and that investors were unable to ascertain what they were actually paying for securities purchased in connection with the margin accounts.

The defendants claim that the allegations, taken as true, do not state a cause of action under 10b-5 or 10b-16 (the latter Rule, it is claimed, affords no private right of action). Further, it is argued, the claim should be dismissed for failing to plead fraud with the specificity required by F.R. Civ. P. 9. Finally, the defendants argue that if its above contentions are rejected, it is entitled to a more definite statement than is provided by the plaintiff's pleadings.

LEGAL ARGUMENT.

1. *Rule 10b-5.* The rule prohibits the making of untrue statements or omissions, or employing any scheme to defraud "in connection with the purchase or sale of any security." The defendants first argue that their conduct with respect to margin accounts is not actionable under 10b-5 because it lacks the necessary "connection with the purchase or sale of any security."

At the outset, it must be noted that the margin accounts themselves are not "securities" within the meaning of 10b-5. *See Salcer v. Merrill Lynch*, 682 F.2d 459 (3d Cir. 1982); *Wasnowic*

v. Chicago Board of Trade, 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd*, 491 F.2d 752. Nor are loans of money, which resemble margin accounts, ordinarily treated as securities. *See Ripso v. Spring Lake Mews*, 485 F. Supp. 462 (E.D. Pa. 1980); *Provident Nat'l Bank v. Frankford Trust Co.*, 468 F. Supp. 448 (E.D. Pa. 1979). Therefore, if defendants are to be held liable under 10b-5, it must be because their operation of margin accounts is "in connection with the purchase or sale of any security." None of the cases the parties have submitted for the court's edification squarely address the question of whether non-disclosure of the interest rates on margin accounts is actionable under 10b-5.

The plaintiff has brought to our attention several cases in which the transfer of stock as security for a loan was treated as a sale of securities. *See Alley v. Miramon*, 614 F.2d 1375 (5th Cir. 1980); *Rubin v. United States*, 449 U.S. 424 (1981); *United States v. Kendrick*, Fed. Sec. L. Rep. (CCH) ¶ 99,004 (9th Cir. 1982). These cases do not appear to be apposite, since the fraud regarding the loans directly induced the transfer. Here, there is nothing in the complaint to suggest that the plaintiff bought or sold securities *because of* anything the defendants failed to disclose concerning the margin accounts. In the case of *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir. 1980), the alleged losses were in the purchase of specific stocks concerning which representations were made. Such is not the case here. Nor are the cases of *Cramer v. General Telephone & Electronic Corp.*, 582 F.2d 259 (3d Cir. 1978) or *United States v. Read*, 658 F.2d 1225 (7th Cir. 1981), on point since both those cases involved fraud in the sale of particular securities, in the *Cramer* case, the security consisting of an ownership interest in a company. Of greater relevance are the *Arrington* and *Mihara* cases, both from the Ninth Circuit. In *Arrington v. Merrill Lynch*, 651 F.2d 615 (9th Cir. 1981), the defendants misrepresented the risks of

purchasing stocks on margin in a declining market *and* the merits of various securities transacted in. The difference between *Arrington* and the instant case is narrower than the difference in the earlier cited cases. Nevertheless, there *is* a difference between misrepresentations concerning the credit terms of margin accounts and misrepresentations concerning the nature of trading on margin in a particular economic climate. The latter misrepresentations strike us as more closely related to the purchase or sale of securities. *Mihara v. Dean Witter*, 619 F.2d 814 (9th Cir. 1980), involved the practice of "churning," in which a broker, in order to earn commissions, makes more transactions for a client than are necessary or desirable. The case is like the present one in that there are no misrepresentations regarding any particular securities, but misrepresentations regarding a general brokerage practice. But we do not read the case, as plaintiff does, to stand for the broad proposition that "a broker's activities are *of necessity* connected with the purchase and sale of securities." Finally, the *Steinberg v. Shearson* case (81-390, Aug. 24, 1982, D. Del.), factually identical to the present one, assumes that margin account credit misinformation is cognizable under 10b-5, but that assumption is not explained. The case is not, therefore, entitled to much weight.

Turning to the defendants' cases, again we find nothing quite on point, although the factual settings are somewhat more comparable to those presented here. *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), was a case in which fraudulent statements were made by a firm about its investment management techniques. Such statements were deemed not sufficiently "in connection with" the purchase or sale of securities as to be covered by 10b-5. This case is somewhat persuasive because margin accounts have more to do with the management of portfolios than they do with the underlying

securities themselves. In *Drasner v. Thomson McKinnon Securities*, 433 F. Supp. 485 (S.D. N.Y. 1977), the court stated:

> The only effect of margin was to provide a deposit as security to the broker who was acting as plaintiffs' agent to effect a contract between plaintiffs and third parties . . . It had no financial connection with plaintiffs' gains or losses which were solely in conjunction with the price movements of the underlying stock.

This case, from within the Second Circuit, is the closest case we have found, but it would appear that, at least in part, the court's decision was affected by its finding that the sophisticated plaintiffs could not claim they were deceived. Finally, in *Pension Boards v. E. F. Hutton*, (Fed. Sec. L. Rep. (CCH) ¶ 99,268, M.D. Pa. 1983), the court ruled that misrepresentations concerning the method of calculating commissions on stock transactions were not covered by 10b-5. This case is relevant because, like the present one, it involves the cost of transacting in securities, rather than the cost or merits of the securities themselves.

It would appear that the circuits differ somewhat in how broadly they read the "in connection with" language of 10b-5. The Seventh Circuit and the Second Circuit apparently are satisfied that 10b-5 applies "even where fraudulent conduct is implicated only tangentially in a securities transaction." *Ketchum v. Green*, 557 F.2d 1022, 1026 (3d Cir. 1977), *interpreting Jannes v. Microwave Communications*, 461 F.2d 525 (7th Cir. 1972); *Drachman v. Harvey*, 453 F.2d 722 (2d Cir. 1972); *Goldberg v. National Bank of N.A.*, (Fed. Sec. L. Rep. (CCH) ¶ 99,555 (S.D. N.Y. 1970). *But see Drasner, supra*. Apparently, the Third Circuit has defined "in connection with" somewhat more narrowly.

Ketchum v. Green and *Tully v. Mott Supermarkets*, 540 F.2d 187 (3d Cir. 1976), view the "in connection with" concept as roughly equivalent to proximate causation. That is, a misrepresentation is "in connection with" the purchase or sale of a security if there is a "causal *connection* between the alleged fraud and the purchase or sale of stock." *Id.* at 194. Based on this construction of 10b-5, we hold that the alleged misrepresentations concerning interest rates on margin accounts are not the type of misrepresentations that are actionable under 10b-5.

In this case, there are no allegations that the defendants made any misrepresentations about any particular securities, or that the costs of securities differed depending on whether one bought or sold on margin or by another means. Nor does the complaint suggest that *because* the plaintiff had a margin account, any particular securities were bought or sold. We agree with the court in *Drasner, supra*, that margin accounts are nothing more than a form of credit, and that the margin accounts are best treated as distinct from the underlying stock transactions. If we were to hold that brokerage firms were liable under 10b-5 for margin violations, it would logically follow that other lending institutions which made credit available for use in stock market transactions could also be liable under 10b-5 on their misrepresentations. Contrary to the court in *Goldberg, supra*, this, we believe, stretches 10b-5 further than it ought to be stretched. With the court in *Pension Boards, supra*, we believe that 10b-5 is primarily a protection against fraud concerning the merits of particular securities, not against every practice brokerage firms engage in, especially where a given practice is of a type not unique to brokerage firms but may also occur outside the stock market. Accordingly, we will dismiss the plaintiff's claims under 10b-5.

2. *Rule 10b-16.* The defendants next claim that the complaint fails to allege a violation of 10b-16, and they further raise the questions of whether 10b-16 even affords a private right of relief.

Rule 10b-16 provides that it is unlawful for a broker to extend credit unless it establishes procedures to assure that each customer, *at the time an account is opened*, is sent a written statement disclosing: the conditions under which interest will be charged; the rates of interest to be charged; the method of calculating interest; the conditions under which interest rates will be changed; and several other factors concerning the extension of credit. Further, the Rule provides that the customer receive at least quarterly statements informing him of the status of his account, and that the broker give the customer 30 days' notice before changing the conditions under which credit is extended. The defendants are correct that some of the allegations in the complaint do not state violations of 10b-16. The Rule does not require a new disclosure prior to each purchase of securities, only prior to the opening of an account. Accordingly, paragraph 16(a) of the complaint will be dismissed. Nor does the Rule require that the broker inform customers of the existence of alternate and lower rates of interest which may be available, but only what its rates of interest on margin accounts are. Accordingly, the part of paragraph 16(e) which alleges this violation will be dismissed. The remainder of the allegations in paragraph 16 of the complaint, read in a light favorable to the plaintiff, may possibly state claims under Rule 10b-16. We must determine, therefore, whether to allow a private cause of action under the Rule.

The court is aware of four cases dealing with the question, none within this circuit. Two cases imply a cause of action, and two refuse to do so. *Liang v. Dean Witter & Co.*, 540 F.2d 1107 (D.C. Cir. 1976), states in a footnote: "It may safely be assumed

that non-compliance with Rule 10b-16 provides the basis for a private cause of action. It is already established that a violation of 10b-5, a rule of disclosure analogous to Rule 10b-16, implies a civil remedy . . . Our recognition here accords with the view that private enforcement of commission rules may provide a necessary supplement to commission action." *Id.* at 1113 n.25. The court in *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303 (E.D. Va. 1981), applying the *Cort v. Ash* test, 422 U.S. 66, 78 (1975), found that Congress intended to create a private remedy. Reasoning that the Truth In Lending Act provided a private remedy, that brokers were specifically exempted from the Act because Congress assumed the Securities and Exchange Commission (SEC) would similarly regulate brokers, and that 10b-16 represents the SEC's effort at regulation, the court concluded that Congress wanted a private cause of action under 10b-16. The *Haynes* court further held that in view of the Rule's plain language and the analogous requirements of the Truth in Lending Act, scienter was not a necessary element of a 10b-16 claim. This court finds the reasoning of *Liang* and *Haynes* more persuasive than that in the cases to the contrary, *Furer v. Paine, Webber*, (CCH) Fed. Sec. L. Rep. ¶ 98, 701 (C.D. Cal. 1982) and *Establissement Tomis v. Shearson*, 459 F. Supp. 1355 (S.D. N.Y. 1978). The *Tomis* case merely states that no case prior to it had squarely held a private cause of action to exist, while the *Furer* case found the legislative history surrounding the Truth in Lending Act ambiguous. Accordingly, we will not dismiss the complaint as to Rule 10b-16.

Finally, the defendants urge that we dismiss the case as failing to plead fraud with the specificity required by Rule 9 of the Federal Rules of Civil Procedure. But essentially what the plaintiff here complains of are omissions, non-disclosures. We regard the complaint as sufficiently specific in stating what should have been

disclosed which was allegedly not, in fact, disclosed. Moreover, the complaint sufficiently alerts the defendants of its alleged violation of Rule 10b-16 so that there is no need for a more definite statement under Rule 12(e). We do not see why the defendants would be unable to respond to the complaint, since all that seems to be required by way of response is for the defendants to submit the written information it sent to margin customers and show how that information meets the reguirements of 10b-16, if it does. Accordingly, we will allow the plaintiff to proceed on her 10b-16 claim and will deny the motion for a more definite statement. The accompanying order will be entered.

JOHN F. GERRY, U.S.D.J.

DATED: December 7, 1983

Opinion and Order

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action No. 83-1270

LAURA ANGELASTRO, on behalf of herself and all others similarly situated,

Plaintiff,

v.

PRUDENTIAL-BACHE SECURITIES, INC., and BACHE HALSEY STUART SHIELDS, INC.,

Defendants.

ORDER

This matter having come before the court on the motion of defendants to dismiss or for a more definite statement; and

This court having considered the pleadings, briefs and arguments of counsel for the respective parties;

It is, this 7th day of December, 1983, hereby ORDERED:

1. The motion to dismiss the claim is GRANTED as to the alleged violations of 17 C.F.R. 240.10b-5;

2. The motion to dismiss the claim is DENIED as to the alleged violations of 17 C.F.R. 240.10b-16; and

3. The motion for a more definite statement is DENIED.

/s/ John F. Gerry

JOHN F. GERRY, U.S.D.J.

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 84-5401 and 84-5427

LAURA ANGELASTRO, on behalf of herself and all others similarly situated, Appellant in No. 84-5427

vs.

PRUDENTIAL-BACHE SECURITIES, INC. and BACHE HALSEY STUART SHIELDS, INC., Appellants in No. 84-5401

(D.C. Civil No. 83-1270)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Present: ADAMS, WEIS and WISDOM*, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel February 26, 1985.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District

---

* Hon. John Minor Widsom, United States Court of Appeals for the Fifth Circuit, sitting by designation.

Judgment of Court of Appeals

Court, entered December 7, 1983, and certified to this Court by the order of the said District Court entered May 11, 1984, be, and the same is hereby affirmed insofar as the order of the said District Court permitting plaintiff to proceed with its complaint under Rule 10b-16. It is further ordered and adjudged that the order of the said District Court dismissing plaintiff's claim under Rule 10b-5 will be reversed and the cause remanded to the said District Court for further procedings consistent with the opinion of this Court.

Costs taxed against the appellants in appeal No. 84-5401 and the appellees in appeal No. 84-5427.

ATTEST:

/s/ Sally Mrvos
Clerk

June 12, 1985

Certified as a true copy and issued in lieu of a formal mandate on July 5, 1985.
Test: M. Elizabeth Ferguson
Chief Deputy Clerk, U.S. Court of Appeals
for the Third Circuit

COMPLAINT FILED IN DISTRICT COURT

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

CIVIL ACTION NO. 83-1270

CLASS ACTION

LAURA ANGELASTRO, on behalf of herself and all others similarly situated,

Plaintiff,

v.

PRUDENTIAL-BACHE SECURITIES, INC. and BACHE HALSEY STUART SHIELDS, INC.,
1810 Chapel Avenue West
Cherry Hill, N.J. 08002
(609) 665-2300

Defendants.

PLAINTIFF DEMANDS TRIAL BY JURY

COMPLAINT

Plaintiff, by her attorneys, alleges as follows:

COUNT I

A. *Jurisdiction, Venue and Nature of Action*

1. This Court has jurisdiction of this action under Section 27 of the Securities Exchange Act of 1934, as amended ("the Exchange Act").

2. Plaintiff brings this action under and pursuant to Section 10(b) of the Exchange act and Rules 10b-5 and 10b-16 adopted by the Securities and Exchange Commission ("SEC") thereunder.

3. In connection with the acts and conduct alleged in this complaint, the defendants directly and indirectly used the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities markets and disseminated false and misleading financial and other information throughout the United States and within the District of New Jersey.

B. *PARTIES*

4. Plaintiff Laura Angelastro is an individual residing in New Jersey who maintained a margin account with defendants and who, as a result of the wrongs alleged herein, purchased and sold various securities. At all material times, including the time period of the wrongs alleged herein, securities purchased or sold by plaintiff were registered with the SEC pursuant to Section 12(b) of the Exchange Act and were listed for trading on various exchanges, including the New York Stock Exchange.

5. Defendant Prudential-Bache Securities ("Prudential-Bache") (with defendant Bache Halsey Stuart Shields, Inc. referred to collectively as "Bache") is a corporation registered as a broker and dealer of securities pursuant to Section 15 of the Exchange Act. Defendant Prudential-Bache is the successor in interest to defendant Bache Halsey Stuart Shields Inc.

6. Defendant Bache Halsey Stuart Shields, Inc. ("Bache-Halsey") is the predecessor in interest to defendant Prudential-Bache and was, during the relevant period, a corporation registered as a broker and dealer of securities pursuant [sic]

Complaint

C. *Class Action Allegations*

7. Plaintiff is a representative of a Class as defined by Rule 23 of the Federal Rules of Civil Procedure and brings this action on behalf of herself and the entire Class. This suit is properly maintained as a class action under Rules 23(a), 23(b)(2) and 23(b)(3) of the Federal Rules of Civil Procedure.

8. During the period commencing January 1, 1977 through and including December 31, 1982 (the "Class Period"), thousands of persons purchased securities through margin accounts maintained with defendants. The Class is defined as all those persons who purchased securities during the Class Period through margin accounts maintained with either defendant.

9. Plaintiff does not know the exact number of Class Members; it is believed, however, that the number of Class Members far exceeds the number practicable for joinder and that the number of Class Members is readily determinable from the records of the defendants.

10. Plaintiff has sustained damages, is committed to pursuing this action and has retained competent counsel experienced in litigation of this nature. Accordingly, plaintiff is an adequate representative of the Class because she has the same interests as all the members of the Class; her claims are typical of the claims of the members of the Class and she will fairly and adequately protect the interests of the Class.

11. The likelihood of individual Class Members prosecuting separate actions is remote due to the relatively small loss suffered by each Class Member as compared to the losses suffered by the Class as a whole. Plaintiff anticipates no difficulty in the management of this litigation.

12. The questions of law and fact common to the Class include:

(a) Whether the defendants herein entered into a course of action for the purpose and/or effect of inducing plaintiff and the members of the Class to purchase various securities for excesive consideration; and

(b) Whether defendants, in order to effectuate such a plan and in connection with such a course of conduct, engaged in acts in violation of Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-16 promulgated thereunder by the SEC.

13. The aforesaid questions of law and fact are common to the Class, predominate over questions affecting only individual members, and a class action is superior to other methods for a fair and efficient adjudication of the controversy since the Class is so numerous that joiner of all members is impracticable.

14. The defendants have acted on grounds generally applicable to the Class thereby making appropriate injunctive relief with respect to the Class as a whole.

D. *The Cause of Action*

15. Plaintiff alleges that commencing on a date prior to January 1, 1977 and continuing thereafter, Bache among other matataers, engaged in acts, transactions, practices and courses of business which operated as a fraud and deceit upon plaintiff and other customers of Bache and omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading to plaintiff and the other Class Members, all in violation of Section

10(b) of the Exchange Act and Rules 10b-5 and 10b-16 promulgated thereunder, as more fully set forth below, the purpose and effect of which were to induce plaintiff and other Class Members to purchase various securities through Bache and to make such purchases for excessive consideration and to sustain other damages.

16. The fraud practiced and devices utilized by Bache in order to induce plaintiff and the other members of the Class to purchase various securities through Bache consisted, *inter alia,* of Bache's intentional concealment of and failure to disclose the following material facts necessary in order to make statements made, in light of the circumstances under which they were made, which are contained in, among other documents, Bache's customer account agreements, Bache's account statements, and various other documents disseminated by Bache to plaintiff and the members of the Class, not misleading to plaintiff and the other members of the Class:

(a) Bache failed to fully and accurately disclose to their margin customers in advance of each purchase of securities through their margin accounts either (i) the specific interest rate that would be charged in connection with each such purchase, (ii) the indicator to which Bache's interest rate would be tied and the spread between such indicator and the interest rate to be charged by Bache, or (iii) the relationship between the interest rate charged by Bache to their customers and Bache's broker's call rate;

(b) Bache failed adequately to disclose the formula pursuant to which interest charges were assessed, with the result that on those occasions when Bache purported to disclose the interest rate that had been charged in connection with a purchase, Bache misrepresented the actual interest rate.

(c) Bache failed to disclose the fact that all amounts credited to their customers' accounts would not be considered in computing daily interest charges to be assessed against those margin accounts or that it would be necessary for Bache's margin customers specifically to request that certain credit balances in their margin accounts be transferred to other accounts in order for interest to be paid by Bache upon such credit balances; and

(d) Bache failed to disclose the fact that increases in the market value of the underlying securities in connection with which credit was extended by Bache would not be considered in determining the extent of credit or in computing interest charges to be assessed against their customers' margin accounts.

(e) Bache failed to disclose the fact that the interest rates available to its customers who maintained margin accounts were variable, the factors upon which the variable rates were determined and the procedures by which its customers could obtain a variable interest rate. In addition, on those occasions when Bache purported to disclose the annual rate of interest that can be imposed it omitted and misrepresented the fact that alternate and lower annual rates of interest were available.

(f) Bache fraudulently implemented its policy of disclosure of its credit terms applicable to margin accounts by, *inter alia,* failing to adequately train or supervise its employees to insure that the policy was effectively and accurately disseminated to its customers, by failing to adequately or accurately disseminate or cause to be disseminated its credit terms applicable to margin accounts and by failing to disclose these facts.

17. Defendants by acting as herein described have manifested a conscious and continuous effort to distort the truth and otherwise

mislead the investing public, which has had the effect of inducing plaintiff and other members of the Class to purchase various securities in margin accounts, all of which violated Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-16 promulgated thereunder.

18. By reason of the aforesaid acts, plaintiff and other members of the Class purchased substantial quantities of securities from Bache during the Class Period, which purchases were for excessive consideration. Further, due to facts which were either fraudulently or recklessly concealed on a uniform and systematic basis from plaintiff and the members of the Class, the margin customers of Bache had no way of effectively calculating at the time of purchase the full cost of the securities purchased in or pursuant to margin accounts. As a consequence thereof, plaintiff and members of the Class sustained financial damages in an amount that cannot presently be calculated.

PRAYER FOR RELIEF

WHEREFORE, plaintiff demands:

(a) Judgment against defendants and in favor of plaintiff and each member of the class in an amount equal to the damages determined to have been sustained by plaintiff and the Class, together with interest and costs of suit, including reasonable attorneys' fees, accountants' fees and punitive damages;

(b) An Order enjoining defendants from continuing to violate Section 10b-5 in the manner alleged herein and requiring defendants to make full disclosure of the terms and manner pursuant to which credit is extended in connection with the purchase of securities, including, but not limited to, published

notice thereof and personal notice to all prior and current customers; and

(c) Such other and further relief as may be necessary and appropriate.

April 4, 1983

GREENFIELD & CHIMICLES

By: _____
Richard D. Greenfield
Robert P. Frutkin
David B. Zlotnick
110 Montgomery Avenue
Bala Cynwyd, PA 19004
(215) 667-1700

and

FELLHEIMER, EICHEN
& GOODMAN

By: _____
Alan Fellheimer
Century Office Bldg.
216 Haddon Avenue
Westmont, N.J. 08108

Attorneys for Plaintiff
and the Class

RULE 10b-5 OF THE SECURITIES AND EXCHANGE COMMISSION, 17 C.F.R. § 240.10b-5

10b-5: Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

RULE 10b-16 OF THE SECURITIES AND EXCHANGE COMMISSION, 17 C.F.R. § 240.10b-16

Rule 10b-16: Disclosure of Credit Terms in Margin Transactions

(a) It shall be unlawful for any broker or dealer to extend credit, directly or indirectly, to any customer in connection with any securities transaction unless such broker or dealer has established procedures to assure that each customer

(1) is given or sent at the tinme of opening the account, a written statement or statements disclosng (i) the conditions under which an interest charge will be imposed; (ii) the annual rate or rates of interest that can be imposed; (iii) the method of computing interest; (iv) if rates of interest are subject to change without prior notice, the specific conditions under which they can be changed; (v) the method of determining the debit balance or balances on which interest is to be charged and whether credit is to be given for credit balances in cash accounts; (vi) what other charges resulting from the extension of credit, if any, will be made and under what conditions; and (vii) the nature of any interest or lien retained by the broker or dealer in the security or other property held as collateral and the conditions under which additional collateral can be required, *provided however,* that the requirements of this Paragraph (a)(1) will be met in any case where the account is opened by telephone if the information required to be disclosed is orally communicated to the customer at that time and the required written statement or statements are sent to the customer immediately thereafter; and *provided further,* that in the case of customers to whom credit is already being extended on the effective date of this Rule, the written statement or statements required hereunder must be given or sent to said customers within 90 days after the effective date of this Rule; and

(2) is given or sent a written statement or statements, at least quarterly, for each account in which credit was extended, disclosing (i) the balance at the beginning of the period; the date, amount and a brief description of each debit and credit entered during such period; the closing balance; and, if interest is charged for a period different from the period covered by the statement, the balance as of the last day of the interest period; (ii) the total interest charge for the period during which interet is charged (or, if interest is charged separately for separate accounts, the total interest charge for each such account), itemized to show the dates on which the interest period began and ended; the annual rate or rates of interest charged and the interest charge for each such different annual rate of interest; and either each different debit balance on which an interest calculation was based or the average debit balance for the interest period, except that if an average debit balance is used, a separate average debit balance must be disclosed for each interest rate applied; and (iii) all other charges resulting from the extension of credit in that account; *provided, however,* that if the interest charge disclosed on a statement is for a period different from the period covered by the statement, there must be printed on the statement appropriate language to the effect that it should be retained for use in conjunction with the next statement containing the remainder of the required information; and *provided further,* that in the case of "equity funding programs" registered under the Securities Act of 1933, the requirements of this Paragraph (a)(2) will be met if the broker or dealer furnishes to the customer, within one month after each extension of credit, a written statement or statements containing the information required to be disclosed under this Paragraph (a)(2).

Rule 10b-16

(b) It shall be unlawful for any broker or dealer to make any changes in the terms and conditions under which credit charges will be made (as described in the initial statement made under Paragraph (a) of this Rule), unless the customer shall have been given not less than thirty (30) days written notice of such changes, except that no such prior notice shall be necessary where such changes are required by law; *provided, however,* that if any change for which prior notice would otherwise be required under this paragraph results in a lower interest charge to the customer than would have been imposed before the change, notice of such change may be given within a reasonable time after the effective date of the change.

15 U.S.C. § 1640(a)

15 U.S.C. § 1640. Civil liability

Individual or class action for damages; amount of award; actors determining amount of award

(a) Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this part, including any requirement under section 1635 of this title, or part D or E of this subchapter with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A)(i) in the case of an individual action twice the amount of any finance charge in connection with the transaction, or (ii) in the case of an individual action relating to a consumer lease under part E of this subchapter, 25 per centum of the total amount of monthly payments under the lease, except that the liability under this subparagraph shall not be less than $100 nor greater than $1,000; or

(B) in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply with the same creditor shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the creditor; and

(3) in the case of any successful action to enforce the foregoing liability or in any action in which a person is determined to have a right of rescission under section 1635

15 U.S.C. §1640(a)

of this title, the costs of the action, together with a reasonable attorney's fee as determined by the court.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional. In connection with the disclosures referred to in section 1637 of this title, a creditor shall have a liability determined under paragraph (2) only for failing to comply with the requirements of section 1635, section 1637(a), or of paragraph (4), (5), (6), (7), (8), (9), or (10) id awxruib 1637(b) of this title or for failing to comply with disclosure requirements under State law for any term or item which the Board has determined to be substantially the same in meaning under section 1610(a)(2) of this title or any of those paragraphs of section 1637(b) of this title. In connection with the disclosures referred to in section 1638 of this title, a creditor shall have a liability determined under paragraph (2) only for failing to comply with the requirements of sectin 1635 of this title or of paragraph (2) (insofar as it requires a disclosure of the "amount financed"), (3), (4), (5), (6), or (9) of section 1638 (a) of this title, or for failing to comply with disclosure requirements under State law for any term which the Board has determined to be substantially the same in meaning under section 1610(a) (2) of this title as any of the terms referred to in any of those paragraphs of section 1638(a) of this title. With respect to any failure to make disclosures required under this part or part D or E of this subchapter, liability shall be imposed only upon the creditor required to make disclosure, except as provided in section 1641 of this title.